# Kintail Energy Inc.

# 1997 Annual Report

*Kintail Energy Inc.*

Dear Shareholder:

I am pleased to present this first report to the shareholders of Kintail Energy Inc. for the year ended December 31, 1997.

**HISTORY**

Kintail was incorporated July 14, 1997 and closed a private placement of shares on August 15, 1997.

An initial public offering of shares, under rules governing junior capital pool corporations, was closed on October 29, 1997.

Trading commenced on the Alberta Stock Exchange on November 12, 1997 with the symbol 'KTE'.

The Company's first shareholders' meeting was held on December 18, 1997 at which an acquisition of oil and gas properties qualifying as the Company's Major Transaction was approved. Also approved at the meeting was a flow through share issue for proceeds of $600,000.

**OIL & GAS PROPERTIES**

Producing properties acquired were mainly in Central Alberta at Pembina, Bashaw, Gilby and Wild River. Net production is 40 BOE/D evenly split between oil and gas. In addition, 6350 net acres (approximately 10 net sections) of undeveloped lands were acquired. A number of drilling locations have been identified on these lands at Gilby and Haynes. Kintail also has 3 sections of 100% working interest land on trend with recent Berkley Petroleum, Imperial Oil and Stampede Oil drilling at Turner Valley. Stampede Oil, in a March 13 ,1998 press release has estimated that a gas pool containing as much as 6TCF exists at Turner Valley, part of which is under Kintail lands.

**FINANCIAL**

Kintail incurred a loss of $30,652 ($0.01 per share) for the period from the date of incorporation on July 14, 1997 to December 31, 1997 and a cash flow deficiency of $27,752 ($0.01 per share). The loss was largely due to general and administrative expenses incurred in association with the identification and evaluation of the Company's Major Transaction.

Although the Major Transaction closed on December 18, 1997, Kintail was entitled to the revenue (net of expenses) from the properties from the effective date of September 1, 1997. Cash flow of $52,096 between the effective date and closing date has been treated as a reduction of the purchase price rather than as income in the accompanying statement of loss and deficit. Had these earnings been included in Kintail's financial statements, the Company would have made a profit of $21,444, rather than the loss of $30,652 for 1997.

## PEOPLE

In March 1998, three outstanding individuals joined Kintail.

Richard G. (Rick) Hoath, P. Eng. has assumed the role of Vice President, Production. He has 15 years experience working with Dome Petroleum, Imperial Oil, Sceptre Resources and most recently as Manager, Acquisitions with Jordan Petroleum.

Scott Oldale, B.Sc. (Geology) is Vice President, Exploration. His 16 years of experience was gained at Petro Canada Resources, Sceptre Resources and was recently Region Manager, West Central Alberta, with Northstar Energy.

Ron A. Parisien, B. Comm. is Controller. Mr. Parisien's 17 years of experience was gained at Petrorep Resources and Bonavista Petroleum where he was Controller.

## FUTURE

At the time of writing this letter, we are negotiating deals that will significantly increase the size and profitability of Kintail Energy. The goal of the corporation is share value appreciation and it is our intent to pursue aggressive growth to achieve this objective.

The Directors, Officers and Employees of Kintail and their families have invested more than $900,000 in the Company and therefore have interests aligned with all shareholders.

I would like to thank you, the owners of the Company, for your trust and support in the creation of Kintail Energy and in our efforts to add value to your investment.

Respectfully submitted on behalf of the Board,

Signed "Paul W. M. Read"

Paul Ward McRae Read, P. Eng.<br>Chairman, President & CEO

April 8, 1998<br>Calgary, Alberta

# Kintail Energy Inc.

**FINANCIAL STATEMENTS**
**DECEMBER 31, 1997**

March 25, 1998

## *AUDITORS' REPORT*

***To the Shareholders of***
***Kintail Energy Inc.***

We have audited the balance sheet of **Kintail Energy Inc.** as at December 31, 1997 and the statements of loss and deficit, and changes in financial position for the period then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1997 and the results of its operations and the changes in its financial position for the period then ended in accordance with generally accepted accounting principles.

Signed ("Price Waterhouse")

**Chartered Accountants**
**Calgary, Alberta**

# *BALANCE SHEET*
***December 31, 1997***

## *Assets*

| | |
|---|---|
| **Current assets** | |
| Cash | $ 441,402 |
| Accounts receivable | 128,096 |
| | 569,498 |
| **Capital assets** *(Note 4)* | 515,204 |
| **Deferred income taxes** | 28,000 |
| | $ 1,112,702 |

## *Liabilities*

| | |
|---|---|
| **Current liabilities** | |
| Accounts payable | $ 78,785 |
| **Provision for site restoration costs** | 200 |
| | 78,985 |

## *Shareholders' Equity*

| | |
|---|---|
| **Capital stock** *(Note 8)* | 1,064,369 |
| **Deficit** | (30,652) |
| | 1,033,717 |
| | $ 1,112,702 |

**Approved by the Board** **"Paul W. M. Read"** **Director** **"James B. Howe"** **Director**

## *STATEMENT OF LOSS AND DEFICIT*

***For the period from the date of incorporation on July 14, 1997 to December 31, 1997***

| | |
|---|---|
| **Revenue** | |
| Oil and gas, net of royalties | $ 21,079 |
| Other income | 3,175 |
| | 24,254 |
| **Expenses** | |
| Operating | 14,928 |
| General and administrative | 32,859 |
| Interest and bank charges | 4,219 |
| Depletion, depreciation and amortization | 2,900 |
| | 54,906 |
| **Loss and deficit at end of period** | $ (30,652) |
| **Loss per share** | $ (0.01) |

## *STATEMENT OF CHANGES IN FINANCIAL POSITION*

***For the period from the date of incorporation on July 14, 1997 to December 31, 1997***

| | |
|---|---|
| **Cash (used in) provided by** | |
| ***Operating activities*** | |
| Net loss for the period | $ (30,652) |
| Add: Non-cash items | |
| Depletion, depreciation and amortization | 2,900 |
| **Cash flow (deficiency) from operating activities** | (27,752) |
| **Change in non-cash working capital** | (49,311) |
| | (77,063) |
| ***Investing activities*** | |
| Acquisition of petroleum and natural gas properties | (517,904) |
| ***Financing activities*** | |
| Issue of capital stock, net of issue costs | 1,036,369 |
| **Increase in cash and cash balance at end of period** | $ 441,402 |
| **Cash flow (deficiency) per share** | $ (0.01) |

## 1 *Incorporation/Nature of business*

The Company was incorporated as 747072 Alberta Ltd. under the Business Corporations Act (Alberta) on July 14, 1997 and subsequently changed its name to Kintail Energy Inc.. The Company was a Junior Capital Pool Corporation as defined under Alberta Securities Commission Policy 4.11 until it completed its major transaction on December 18, 1997.

## 2 *Summary of significant accounting policies*

**a) Petroleum and natural gas properties and related depletion and amortization**
The Company follows the full cost method of accounting, whereby all costs incurred in exploring for and developing oil and gas reserves are capitalized. Such expenditures include land acquisition costs, geological and geophysical expenses, carrying charges for unproved properties, costs of drilling both productive and non-productive wells, gathering and production facilities and general and administrative costs directly related to exploration and development activities. Capitalized costs are accumulated on a country-by-country basis and are depreciated and depleted using the unit of production method based upon estimated proved reserves. Costs directly associated with the acquisition and evaluation of unproved properties are initially excluded from the computation of depletion. These unevaluated properties are assessed periodically to ascertain whether impairment has occurred. When proved reserves are assigned or the property is considered impaired, the cost of the property or the amount of the impairment is added to all other capitalized costs subject to depreciation and depletion.

The Company calculates a ceiling test whereby the net capitalized costs of properties, less deferred income taxes and the provision for site restoration costs, cannot exceed an amount equal to the estimated undiscounted value of future net revenues from proved oil and gas reserves, based on current prices and costs, after deducting estimated future general and administrative expenses, future removal and site restoration costs, financing costs, and income taxes, all undiscounted and unescalated.

Sales of oil and gas properties are accounted for as adjustments of capitalized costs, with no gain or loss recognized unless such adjustments would alter the rate of depletion and amortization by more than twenty percent.

**b) Joint ventures**
Substantially all of the Company's exploration and production activities are conducted jointly with others. These financial statements reflect only the Company's proportionate interest in such activities.

**c) Site restoration costs**
Estimated future site restoration costs are provided for over the life of the proved reserves on a unit of production basis. Site restoration expenditures are charged to the accumulated provision account as incurred.

d) **Earnings and cash flow per share**
Per share information is calculated on the basis of the weighted average number of common shares outstanding during the year.

e) **Flow-through shares**
The resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share arrangements are renounced to investors in accordance with Canadian income tax legislation. Petroleum and natural gas properties and capital stock are reduced by the estimated cost of the renounced tax deductions when the expenditures are incurred.

## 3 *Property acquisitions*

On December 18, 1997, the Company purchased certain petroleum and natural gas properties and production equipment for cash consideration of $570,000, which was subsequently reduced by $52,096 representing the earnings from these properties between the effective date of the acquisitions on September 1, 1997 and closing on December 18, 1997. This transaction qualified as the Company's major transaction as defined in Policy 4.11 of the Alberta Securities Commission.

## 4 *Capital assets*

| | December 31, 1997 | | |
|---|---|---|---|
| | Cost | Accumulated depletion and depreciation | Net book value |
| Petroleum and natural gas properties and production equipment | $ 517,904 | $ 2,700 | $ 515,204 |

## 5 *Bank loan*

At December 31, 1997, the Company had a short-term credit facility of $350,000 which was undrawn at December 31, 1997. The facility bears interest at prime plus 1% and is secured by a first fixed charge on the Company's petroleum and natural gas properties and a floating charge on other assets.

## 6 *Financial instruments*

The Company's financial assets and liabilities at December 31, 1997 comprised cash, accounts receivable and accounts payable. Due to their current nature, fair value for these items is considered to be equal to book value.

A substantial portion of the Company's accounts receivable are with counterparties in the oil and gas industry and are subject to normal industry credit risk.

## 7 *Related party transactions*

On December 18, 1997, the Company closed two separate non-arms length property acquisitions as further described in Note 3. The first transaction for cash consideration of $359,000 was purchased from a corporation owned by the President, Chief Executive Officer and a Director of the Company. The second transaction, for cash consideration of $211,000 was purchased from a limited partnership of which the General Partner is a corporation owned by the spouse of the President of the Company. In addition, the President of the Company owns 5.5% of the partnership units of the vendor. The purchase price of both transactions was based on a reserve report prepared by independent engineering consultants and was based on discounted net present values, net of abandonment costs with probable reserves discounted a further 50% to reflect the risk of recovery.

## 8 *Capital stock*

a) **Authorized**
Unlimited number of common shares
Unlimited number of preferred shares

b) **Issued**

| | Number | Amount |
|---|---|---|
| Common shares | | |
| Issued on private placement | 2,000,000 | 200,000 |
| Issued on public offering | 1,500,000 | 300,000 |
| Issued on private placement of flow through shares | 1,500,000 | 600,000 |
| Share issue costs net of deferred income taxes of $28,000 | - | (35,631) |
| | 5,000,000 | 1,064,369 |

The $600,000 attributable to the issue of flow through shares will be reduced by the estimated cost of the renounced tax deductions when the exploration and development expenditures are incurred in 1998.

c) **Options**
The Company has established a stock option plan for its directors, officers, and employees and has granted 350,000 options to purchased common shares at an exercise price of $0.20 per share expiring on October 29, 2002. In addition, 150,000 options to purchase common shares at an exercise price of $0.20 per share expiring on April 29, 1999 were granted to the agent in connection with the public share offering.

## 9 *Income taxes*

The Company has a loss available to offset future income for tax purposes of $5,500 which expires in 2004. In addition, the tax cost of capital assets at December 31, 1997 exceeds the book cost by $27,000. The potential benefit of these items has not been recognized in the financial statements.

## 10 *Subsequent events*

Subsequent to December 31, 1997, as part of employment packages to three newly recruited officers, the Company issued by private placement 462,976 units, each unit consisting of one common share plus one common share purchase warrant for proceeds of $250,000 which was funded 50% by means of an interest free loan to the individuals by the Company. The warrants are exercisable for a two year period from the date of issue, of which 377,360 warrants are exercisable at a price of $0.86 per warrant and the remaining 85,616 warrants are exercisable at a price of $0.93 per warrant. In addition 150,000 options to purchase common shares were issued at an exercise price of $0.66 per share.

# Corporate Data

**KINTAIL ENERGY INC.**

*Corporate Offices (Effective May 1, 1998)*
Petro Canada Centre (West Tower)
4100, 150 - 6th Avenue SW Tel: (403)269-2240
Calgary, AB T2P 3Y7 Fax: (403)266-8893

*Officers & Directors*
Paul Ward McRae Read, P. Eng.
Chairman, President and Chief Executive Officer

James B. Howe, C.A.
Vice President, Finance, Chief Financial Officer,
Corporate Secretary & Director

Stephen D. Adams. M.A.
Director

Thomas W. Robinson, LLB
Director

Richard (Rick) G. Hoath, P. Eng.
Vice President, Production

Scott Oldale, B.Sc. (Geology)
Vice President, Exploration

Ron A. Parisien, B. Comm.
Controller

Annual
General
Meeting

May 21, 1998
4:00 pm
Calgary, Petroleum Club
Calgary, AB

*Transfer Agent*
Montreal Trust Company
Calgary, AB

*Bankers*
Bank of Nova Scotia
Calgary, AB

*Auditors*
Price Waterhouse
Calgary, AB

*Legal Counsel*
Johnston Robinson Clark
Calgary, AB

*Stock Listing*
Alberta Stock Exchange
Calgary, AB

*Trading Symbol*: KTE

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